Noncontrolling Interests and Consolidation Accounting: The Full Tutorial

A Minority Interest by Any Other Name...
We get a lot of questions about Noncontrolling Interests, how they work on the statements, how to model them, and so on...

...and we have detailed tutorials, including a dedicated case study (Fortum / Uniper) in our courses.
Here, we’ll cover some of the key points in around 15-20 minutes and explain what you need to know for interviews.

Noncontrolling Interests are difficult mostly because of naming conventions, not because the ideas are hard.
Noncontrolling Interests: The Short Version

This part is the Noncontrolling Interest!

Parent Company

Owns a majority stake in Sub Co., shown in red:

Sub Co.
Noncontrolling Interests: The Short Version

• When a Parent Company (Parent Co.) owns between 50% and 100% of another company (Sub Co.), it must consolidate that company’s financial statements with its own.

• So: You add together 100% of Parent Co.’s and Sub Co.’s numbers, even if Parent Co. owns only 60%, 70%, or 80% of Sub Co.

• And: You also make some adjustments for Sub Co.’s Net Income and Dividends.

• Net Income: Subtract (1 – Ownership Percentage) * Sub Co.’s Net Income at the bottom of the combined Income Statement.
Outline for This Tutorial:

• **Part 1:** How Noncontrolling Interests Get Created

• **Part 2:** Full Consolidation on the 3 Financial Statements

• **Part 3:** Noncontrolling Interests in Valuation
Part 1: Noncontrolling Interest Creation

• **Plan:** To understand NCIs fully, it helps to see the full process from creation through the financial statements

• **Assumption:** Parent Co. *already owns* 30% of Sub Co., so it has an **Equity Investment** for 30% of Sub Co. on its Balance Sheet

• **Now:** Parent Co. wants to increase its stake to 70%, so it will consolidate its statements with Sub Co.'s 100%

• **Process:** Since this acquisition will result in >= 50% ownership, Goodwill will be created, along with all the usual M&A items (asset write-ups, deferred tax line items, etc.)
Part 1: Noncontrolling Interest Creation

• **One More Wrinkle**: Parent Co. acquired its 30% stake when *Sub Co. was worth a different amount (different Market Cap!)*

• **EX**: Parent Co. acquired this 30% stake when Sub Co. was worth $50, but now it’s going to buy an additional 40% when Sub Co. is worth $100

• **So**: We’ll need to make an adjustment for this change, or the combined Balance Sheet will not balance

• **Goodwill**: Still based on Equity Purchase Price for 100% of Sub Co. and a full write-down of Sub Co.’s Common Equity
Part 1: Noncontrolling Interest Creation

• **Balance Sheet:** Add all of Sub Co.’s Assets and Liabilities to Parent Co.’s but **exclude Sub Co.’s Common Equity** because it’s written down in the deal!

• **Assets Side:** Add the new Goodwill and remove the old Equity Investment line item; subtract any Cash used to fund the deal

• **L&E Side:** Add any Debt or Stock used to fund the deal

• **Equity:** Create a **Noncontrolling Interest** based on \((1 – \text{New Ownership Percentage}) \times \text{Sub Co.’s Market Cap}\); also record the “Premium or Discount” adjustment here
Part 2: Full Consolidation on the 3 Statements

• **This Step:** We’ll assume that Parent Co. continues to own 70% of Sub Co. over several years

• **Income Statement:** Literally add together all of Parent Co.’s numbers and all of Sub Co.’s numbers

• **Adjustment:** And subtract \((1 - \text{Ownership Percentage}) \times \text{Sub Co.'s Net Income at the bottom}\)

• **Cash Flow Statement:** Gets more complicated, which is why we skipped it in the “short version”... but you can start by adding together most of these line items once again
Part 2: Full Consolidation on the 3 Statements

- **Dividends**: In real life, you’ll see just one line item for the Combined Dividends, but we prefer to list the Parent Co. and Sub Co. numbers separately.


- **Dividends, Part 2**: And add Sub Co. Dividends * Ownership Percentage in CFO.

- **And**: For the “Beginning Cash” in the first year, link to the post-transaction Cash number.
Part 2: Full Consolidation on the 3 Statements

• **Balance Sheet:** Most items are simple combinations, but a few are more complicated...

• **Cash:** Flows in from the bottom of the Cash Flow Statement

• **Equity Investments:** It’s 0 now, but might as well maintain it by linking in Equity Investment Net Income and Dividends

• **Common Shareholders’ Equity (CSE):** Old CSE + Net Income to Parent + Parent Co. Dividends + Stock Issuances + Stock Repurchases

• **Why:** Dividends and Repurchases have negative signs!
Part 2: Full Consolidation on the 3 Statements

- **Noncontrolling Interests (NCI):** Old NCI + Net Income to NCI + Dividends Received from Partially Owned Companies Only If Parent Co. Owns >= 50% + Sub Co. Dividends

- **Why:** The NCI is like a “mini-Shareholders’ Equity” for the minority shareholders in Sub Co. (i.e., the Non-Parent ones)

- **Net Dividends:** Only the portion that goes to the Non-Parent shareholders! Since we remove the Dividends that the Parent receives

- **So:** As with normal CSE, we’re adding Net Income and deducting Dividends… but only for a specific group
Part 3: Noncontrolling Interests in Valuation

• **Equity Value to Enterprise Value Bridge:** Add the Noncontrolling Interests because they represent another “investor group”

• **Why:** The NCI represents the *minority shareholders* in this *majority-owned company* – effectively another investor group for the Parent

• **And:** Since metrics like EBITDA, EBIT, and Revenue include 100% of the Sub Co.’s financials, for consistency, Enterprise Value must include 100% of Sub Co.

• **Values:** Use Market Value if you can; if not, Book Value is fine
Recap and Summary

• **Part 1:** How Noncontrolling Interests Get Created

• **Part 2:** Full Consolidation on the 3 Financial Statements

• **Part 3:** Noncontrolling Interests in Valuation